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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1950

No. ———

E. T. RENFRO DRUG COMPANY,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit, entered in the above-entitled case on July 27, 1950.

OPINIONS BELOW

The opinion of the Tax Court of the United States is reported in 11 T.C. 994. The opinion of the Court of Appeals for the Fifth Circuit is reported in 183

Fed. (2d) 846. On September 13, 1950, the Court of Appeals for the Fifth Circuit entered an order (unreported) denying a petition for rehearing filed in that Court.

QUESTION PRESENTED

Whether four certain partnerships that were dissolved, but not terminated, constituted its "component corporations," and E. T. Renfro Drug Company their "acquiring corporation," within the purview of Sections 740, 742 and 743 of the Internal Revenue Code, so that petitioner was entitled, under the provisions of Sections 710(b)(2) and 710(b)(3) of the Internal Revenue Code, to use the base-period earning experience of the four said partnerships in determining the amount of the excess profits credit (current year) and unused profits credit (from prior years) to be used in fixing petitioner's excess profits tax liability for the calendar years 1942 and 1943.

STATUTES INVOLVED

The pertinent statutory provisions and applicable Treasury regulations are printed in Appendix A, *infra*, pp. 15 to 31.

STATEMENT

Throughout the years 1936, 1937, 1938, and for most of the year 1939, Inez Renfro, Inez Renfro Allen (Mrs. Frank F. Allen) and C. L. Wren were equal partners, each owning a one-third interest, in four separate

partnerships known as Renfro Drug Stores No. 1, 9, 15 and 20, each of which partnerships owned and operated a drug store in Fort Worth, Texas.

In October 1939, Inez Renfro and Inez Allen entered into a verbal agreement to purchase the interest of Wren in the four said partnerships. It was agreed that this sale should be effective as of December 31, 1939, and that Wren should receive the book value of his interests in the partnerships as of the close of business on that day, according to a formula agreed upon by the parties. To operate this formula, time was necessary after the close of business on the effective date, so that a bill of sale was not actually delivered from Wren to Inez Renfro and Inez Allen until February 3, 1940. On February 14, 1940, Inez Renfro and Inez Allen conveyed to petitioner, solely in exchange for 574.33 shares of the common stock of E. T. Renfro Drug Company, issued one-half to Inez Renfro and one-half to Inez Allen, all of their interests in and to the four said partnerships, viz., Renfro Drug Stores No. 1, 9, 15 and 20, and the business and properties of such partnerships.

Immediately after the transfer to petitioner of one hundred per cent (100%) of the four partnerships, Inez Renfro and Inez Allen owned in equal amounts more than eighty per cent of the authorized, issued and outstanding capital stock of E. T. Renfro Drug Company.

The base-period net incomes of the four said stores were as follows:

Store No.	1936	1937	1938	1939
1	$2,682.15	$ 1,182.39	$(-1,080.89)	$(-1,123.81)
9	9,448.82	12,452.56	12,405.59	8,216.35
15	6,165.63	4,285.34	3,141.26	1,807.50
20	2,819.19	2,991.83	3,760.31	1,159.17

In its excess profits tax returns (sub-chapter E, chapter 2, Internal Revenue Code) for the calendar years 1940 to 1943, inclusive, petitioner calculated its excess profits credit under the average-earnings method by including in its base-period net income the average base-period net income of the four said stores, as provided in Sections 740 and 742, Internal Revenue Code.

The Tax Court of the United States, in its opinion below and in its orders entered pursuant thereto redetermining the deficiencies involved in this proceeding, held and determined that upon and solely because of the sale to Inez Renfro and Inez Allen of Wren's interests in Renfro Drug Stores No. 1, 9, 15 and 20, one of two events occurred: Either there was then created a new partnership or partnerships between Mrs. Renfro and Mrs. Allen which acquired the assets of the old partnerships; or the assets of the old partnerships were acquired by Inez Renfro and Inez Allen in joint proprietorship.

The Tax Court further held that, in either event, the properties of the four said partnerships, viz.,

Renfro Drug Stores No. 1, 9, 15 and 20, passed through the hands of a partnership or of individuals who could not, under the statute and regulations, transfer to the corporation the base experience of the four said partnerships during the base period because the "intervening proprietors" (as found by the Tax Court) were not "acquiring corporations" as defined in the Internal Revenue Code.

The Court of Appeals for the Fifth Circuit, Hutchinson, Chief Justice, dissenting, affirmed the decision of the Tax Court.

SPECIFICATION OF ERRORS TO BE URGED

The United States Court of Appeals for the Fifth Circuit erred:

(1) In holding and deciding that petitioner was not an "acquiring corporation" within the purview of Section 740, Internal Revenue Code, as to the properties and businesses of those said four drug store partnerships known as Renfro Drug Stores No. 1, 9, 15 and 20, respectively, being those four certain drug store partnerships acquired by petitioner from Inez Renfro and Inez Allen through the issuance of its capital stock;

(2) In holding and deciding that petitioner was not entitled to include the base-period net incomes of the said four partnerships in computing its excess profits credit under the average-earnings method for

the years 1940 to 1943, inclusive, as provided by Sections 740 and 742, I.R.C.;

(3) In failing to hold that, as to such four partnership stores, petitioner was an "acquiring corporation" within the purview of Section 740 of the Internal Revenue Code;

(4) In failing to hold and decide that petitioner is entitled to include the base-period net incomes of the said four partnerships in computing its excess profits credit under the average-earnings method for the years 1940 to 1943, inclusive, as provided in Sections 740 and 742, I.R.C.; and

(5) In affirming the decision of the Tax Court of the United States that E. T. Renfro Drug Company was due deficiencies in 1942 and 1943 (sub-chapter E, chapter 2, I.R.C.) excess profits taxes in the respective amounts set out in the order entered by the Tax Court of the United States on December 9, 1948.

REASONS FOR GRANTING THE WRIT

(1) The decision of the Tax Court of the United States, affirmed by the Court below, was wrong. It is in direct conflict with the principles announced and applied by the Tax Court in the appeal of *Ransohoffs, Inc.*, 9 T.C. 376, in which case the Tax Court rightly concluded that where a partnership was dissolved by the death of one of the partners, but its business continued by the surviving partners, who thereafter trans-

ferred the partnership business to a corporation solely in exchange for the capital stock of the corporation to which the transfer was made, the base period experience of the partnership might be used in fixing the excess profits credit of the transferee corporation. In so holding, the Tax Court, among other things, (9 T.C. 376, page 382) said:

> "We have found no prohibition in the Federal taxing statutes against the continuance of a partnership for tax purposes after the death of a partner. *Moreover, the basic purpose of Section 740 must not be overlooked. It is a remedial measure and, as such, it is axiomatic that it be construed liberally. It was intended to give the petitioner the benefit of the business experience of its predecessor.*" (Emphasis supplied).

The decision below is wrong because, in fixing petitioner's "excess" earnings subject to war excess profits taxes (purposely framed by the Congress to be just short of confiscatory), the Court below improperly denied petitioner the benefit of the base-period business experience of four businesses (drug stores) owned and operated by petitioner in excess profits tax years that were in existence and operating in the base period (years 1936 to 1939, inclusive) selected by the Congress as a yard stick for measuring normal peacetime business conditions.

(2) While neither this Court nor any Court of Appeals has decided the precise question presented by the case at Bar, and the decision below is therefore not in direct conflict with a decision of this Court nor of

another Court of Appeals, in its decision in this case, the Court below ignored and failed to apply the legal principles announced by this Court in *Heiner* v. *Mellon*, 304 U.S. 271, and the principles applied by the Circuit Court of Appeals for the Second Circuit in *Rossmore* v. *Anderson*, 67 Fed. (2d) 1009 (affirming Rossmore v. Anderson, 1 Fed. Supp. 35). It also ignored settled Texas law.

The general rule is that, while the death or withdrawal of a partner *dissolves* a partnership, on such dissolution the partnership is not *terminated*, but continues until the winding up of the partnership affairs is completed (*Heiner* v. *Mellon*, 304 U.S. 271; *Rossmore* v. *Commissioner*, 76 Fed. (2d) 520, 521 (C.A. 2); *Dial* v. *Martin*, 37 S.W. (2d) 166, 177 (Tex. Civ. App.), affirmed 57 S.W. (2d) 75, 81 (Tex. Com. App.); Rowley, *Modern Law Partnership* (1916), Secs. 579, 615).

After Mrs. Renfro and Mrs. Allen bought out Wren, they proceeded to wind up the affairs of the partnership by transferring all (100%) of the four so-called Wren partnerships, and their assets and businesses, to petitioner corporation in exchange for its capital stock, which was issued to them in liquidation of their partnership interests. Such transfer of the assets and businesses of the various partnerships to petitioner corporation fell squarely within the purview of Section 112(b)(5) of the Internal Revenue Code, and accordingly, within the purview of Sections 740 and 742 of the Internal Revenue Code.

Contrary to the principles announced in *Heiner* v. *Mellon, supra,* and *Rossmore* v. *Commissioner, Supra,* the Court below held that, as the mere result of Wren's withdrawal, and without more, new partnerships or a joint proprietorship sprang into being, with the end result that what was transferred to petitioner for its stock was not the assets and businesses of four partnerships that were in existence in the base period, but assets and businesses belonging to new partnerships or a new joint proprietorship. The Court below erred in so holding.

(3) Through statutory enactments (such as Section 113(a)(13), Internal Revenue Code) and Federal court decisions, at the time of the enactment of Sections 740 and 742 of the Internal Revenue Code, the strict theories of the common law with respect to partners and partnerships had been modified, and the status of partners and partnerships clarified and reasonably stabilized. Whatever might be the holding in other fields with regard to the entity theory of partnerships, it was then and is now too late to question it in the law of taxation. The Tax Court of the United States, in other cases, has recognized this priciple, *cf*: *Appeal of J. C. Wynne,* 47 B.T.A. 731, 735, and so have various of the Courts of Appeals. Speaking of the modifications imposed in equity and in bankruptcy upon the rights and liabilities of partners as the common law conceived them, and the adoption of such modifications by the Congress, the Court of Appeals for the Second Circut (L. Hand, Judge) in *Commissioner of Internal Revenue* v.

Lehman (165 Fed. (2d) 383, certiorari denied 334 U.S. 819) said:

> "While the firm never became a *jural person* capable of being sued and suing as such, in the administration of its affairs it did become for most purposes *an entity; and it was upon this traditional structure that Congress fitted the taxation of partnerships*, although it levied the income tax upon the separate distributive shares of the partnership, whether distributed or not." (Emphasis supplied).

In a long line of cases dealing with the question whether, for capital gain purposes, the sale of an interest in a partnership constitutes the sale of a single capital asset, the partnership interest itself, or the sale of an undivided interest in each underlying partnership asset (essentially the question whether, for most tax purposes a partnership is an entity or an aggregation of individuals, although the courts had been reluctant to so label the question), the overwhelming weight of authority is to the effect that the sale is of the selling partners' partnership interest as such. See: *Adam Kessler, Jr.*, v. *United States*, 124 Fed. (2d) 152; *Commissioner* v. *Morris Shapiro*, 125 Fed. (2d) 532; *George H. Thornley et ux.* v. *Commissioner*, 147 Fed. (2d) 416; *Commissioner* v. *Estate of Daniel Gartling et al.*, 170 Fed. (2d) 73; *Commissioner* v. *Allan S. Lehman*, 165 Fed. (2d) 383, certiorari denied, 334 U.S. 819; *Commissioner* v. *H. R. Smith*, 173 Fed. (2d) 470, certiorari denied, October 10, 1949; *L. F. Long* v. *Commissioner*, 173 Fed. (2d) 471, certiorari denied, October 10, 1949; *Max Shapiro* v. *United States*, 83 Fed. Supp. 375. Such overwhelming

weight of authority has been formally recognized by the Treasury Department in G.C.M. 26379, published in Internal Revenue Bulletin, No. 10 (May 15, 1950) at page 4, in which the Treasury Department bowed to such weight of authority and said it was abandoning its long battle to support, through the courts, its "partner's undivided interest in each specific partnership asset" theory. However, in *Girard Trust Company et al, Executors under the will of Samuel P. Kenworthy*, v. *United States*, Docket No. 10130 in C. A. 3rd, decided June 7, 1950 (unreported), the Commissioner again relied upon the doctrine that a partnership is merely an aggregation of individuals, and questioned, for tax purposes, the right of partners, by agreement, to provide that a partnership should continue after the death or withdrawal of a partner.

Because the Treasury Department and the Tax Court of the United States (as witness its opinion and decision below) blow first hot, then cold, over this question, one that is fundamental to the disposition of many complicated questions concerning the proper application of Federal tax laws to partners and partnerships, this Court should set the whole matter at rest and authoritatively decide whether a partnership, for Federal tax purposes, (although its income is taxed to the individual partners as is, under some circumstances, the income of a personal service corporation) does or does not constitute an entity which, after its formation, continues to exist until it is not only dissloved, but also terminated by the liquidation of its assets. This it can do by reversing the decision below.

(4) The statutory provisions determinative of the issue involved in this proceeding were enacted by the Congress in the exercise of its plenary power, under the Constitution, to tax income. In the absence of language evidencing a different purpose (and there is none), they are to be interpreted so as to give a uniform application to be a nation-wide scheme of taxation.[1] In enacting them, it was not the intention of the Congress that their impact was to be governed by whether a particular state had adopted the uniform partnership laws, or had or had not provided that partners might contract to extend the existence of a partnership after the death or withdrawal of a partner. Such nation-wide, uniform application, not only as to the precise issue involved in the case at Bar, but as to many other questions relating to the taxation of partners and partnerships that readily suggest themselves, cannot be achieved so long as the decision below remains unreversed.

Clearly the question presented by the case at Bar is of material importance in the administration of the Federal revenue laws.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

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[1] Burnet v. Harmel, 287 U.S. 103.

Respectfully submitted,

R. B. CANNON
Counsel for Petitioner

December ——, 1950.